

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact: [REDACTED]

Telephone Number: [REDACTED]

Refer Reply to:

CP:E:EO:T:3

Date:

DEC 11 1996

*Leah*  
*1/27/97*

Employer Identification Number: [REDACTED]

Key District: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption under section 501(c)(3) of the Internal Revenue Code.

The information submitted indicates that you were incorporated on [REDACTED]. On [REDACTED], you amended your Articles of Incorporation to include that you were formed for purposes described in section 501(c)(3) of the Code. Specifically, your purpose is, and your activity will be, to make charitable contributions to various organizations for providing scholarships.

You are a private foundation which will rely primarily for financial support from contributions from [REDACTED]. Your Bylaws provide that your member shall have the sole and exclusive authority to appoint the members of the Board of Directors. Currently, your four-member Board of Directors consists of [REDACTED] and [REDACTED] family.

[REDACTED] (the "LP") is a limited partnership formed on [REDACTED] to acquire, own, manage, and lease certain properties in [REDACTED] and township [REDACTED]. The LP is capitalized at \$[REDACTED] with capital contributions of \$[REDACTED] from its General Partners, [REDACTED], and \$[REDACTED] from the sale of [REDACTED] each of limited partnership interests. You have submitted a copy of Certificate of Limited Partnership Interest in the LP indicating that [REDACTED] had contributed and/or promised \$[REDACTED] to the LP in exchange for a limited partnership interest.

On [REDACTED] transferred to you, as a contribution, his share of limited partnership interest in the LP. At the date of transfer, the limited partnership interest you acquired had a negative capital balance of \$[REDACTED]. The negative capital account balance represents accumulated prior years losses. With a negative capital balance you indicated that no cash receipts are anticipated to be received from the LP until the capital balances of the partners have reached or exceeded a zero-dollar level. The LP has projected that it will show substantial losses on operation on its early ten-year period of operation primarily from a substantial amount of depreciation and interest expense on mortgage notes. A turn-around in operation showing income is projected after more than ten years following the exhaustion of depreciation expenses.

Beginning with the calendar year [REDACTED], the year you were formed, there was a turn-around in the LP reporting income from operation. In [REDACTED], LP reported income in which it reported your share of the income, per Schedule K-1, Partner's Share of Income, Credits, Deductions, etc., was \$[REDACTED], \$[REDACTED] and \$[REDACTED], respectively. You received no cash distributions of such income, however, because during those years you had a negative capital account balance. Currently, your current negative capital account balance in the LP is \$[REDACTED].

You indicate that you have not had significant past activities. You have not shown that you have provided grants to charitable organizations to carry your purpose nor have received funds from [REDACTED], your anticipated primary source of funding for these purposes. You indicate, however, that once your application is approved, [REDACTED] will donate "additional" funds, anticipated to be \$[REDACTED] each year in [REDACTED] and [REDACTED] for scholarships.

Section 501(c)(3) of the Code provides, in part, for the exemption from federal income tax for corporations organized and operated exclusively for charitable and other exempt purposes, provided no part of the corporations net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(a)-1(c) of the Income Tax Regulations defines "private shareholder or individual" as persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more exempt purposes specified in section 501(c)(3). An organization will not be so regarded if

more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized exclusively for any of the purposes specified in section 501(c)(3) unless it serves public, rather than private interests. Thus, an organization applying for tax exemption under section 501(c)(3) must establish that it is not organized or operated for the benefit of private interests, such as the creator or his family, or persons controlled, directly or indirectly, by such private interests.

Rev. Rul. 69-266, 1969-1 C. B. 151, held that an organization whose primary function is to serve the private interest of its creator rather than a public interest does not qualify for exemption under section 501(c)(3) of the Code.

Rev. Rul. 69-279, 1969-1 C.B. 152, holds that a trust which is organized and operated for two purposes, to benefit the settlor and to benefit charity, is not organized and operated exclusively for charitable purposes. Therefore, the trust does not qualify for exemption under section 501(c)(3) of the Code.

Rev. Rul. 76-441, 1976-2 C.B. 147, Situation 2, describes a nonprofit organization which received as a gift all of the stock of a for-profit entity whose liabilities exceeded the fair market value of its assets. The organization's Board of Directors is composed of the former owners of the stock of the for-profit entity. The ruling held that the organization is substantially serving the directors' private interests. The directors were, in fact, dealing with themselves and will benefit financially from the transaction. Therefore, the organization is not operated exclusively for exempt purposes and does not qualify for exemption under section 501(c)(3) of the Code.

In Better Business Bureau of Washington, Inc. v. United States, 315 U.S. 279 (1945), the Supreme Court interpreted the requirement in section 501(c)(3) that an organization be "operated exclusively" by indicating that in order to fall within the claimed exemption, an organization must be devoted to exempt purposes exclusively. This means that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption, regardless of the number and importance of truly exempt purposes.

Operating for the benefit of private parties constitutes a substantial nonexempt purpose. Old Dominion Box Company, Inc. v. United States, 477 F.2d 340 (4th Cir. 1973), cert. denied 413 U.S. 910 (1973).

any economic benefits, it provided the transferor, [REDACTED] with certain economic benefits. As such, your financial arrangement serves primarily the private interests of [REDACTED] and is not in furtherance of an exempt purpose under section 501(c)(3) of the Code.

By serving a private rather than public interest, you are not operated exclusively for an exempt purpose pursuant to section 1.501(c)(3)-1(d)(1)(ii) of the regulations. See also Rev. Rul. 69-266.

Also, by engaging in a substantial non-exempt purpose, you are not operated exclusively for an exempt purpose pursuant to section 1.501(c)(3)-1(c)(1) of the regulations. See also Old Dominion Box Company, Inc. supra. You are indistinguishable from the situation described in Rev. Rul. 76-441 which held that the arrangement to receive a donation of an asset with negative networth is serving private interests precluding exemption under section 501(c)(3) of the Code.

Because you have two purposes: a charitable purpose (yet to be accomplished), and serving private interests, you are not operated "exclusively" for exempt purposes. As held in Rev. Rul. 69-279, and applying the principles used by the courts in Better Business Bureau, supra and The Leon A. Beechly Fund, supra, your non-exclusive operation for exempt purposes disqualifies you from exemption under section 501(c)(3) of the Code.

Therefore, we conclude that you do not qualify for exemption under section 501(c)(3) of the Code.

Contributions to you are not deductible under section 170 of the Code.

You are required to file federal income tax returns on Form 1120.

You have the right to protest our ruling if you believe that it is incorrect. To protest, you should submit a statement of your views, with a full explanation of your reasoning. This statement must be submitted within 30 days of the date of this letter and must be signed by one of your officers. You also have a right to a conference in this office after your statement is submitted. If you want a conference, you must request it when you file your protest statement. If you are to be represented by someone who is not one of your officers, he/she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and copies will be forwarded to your key District Director in Baltimore, Maryland. Thereafter, if you have any questions about your federal income tax status, including questions concerning reporting requirements, please contact your key District Director.

The appropriate State Officials will be notified of this action in accordance with section 6104(c) of the Code.

Sincerely,

~~Edward K. Karcher~~

Edward K. Karcher  
Chief, Exempt Organizations  
Rulings Branch 3

copy: [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

copy: DD, Southeast (Baltimore, MD)  
Attn: Chief, EP/EO Division